MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2017/2018

BFN2234 – PRINCIPLES OF CORPORATE FINANCE

(All sections / Groups)

14TH OCTOBER 2017
(2 Hours)
2.30 P.M – 4.30 P.M

INSTRUCTIONS TO STUDENTS

1. This question paper consists of **THREE (3)** printed pages (excluding cover page) with **FOUR (4)** questions.

2. Attempt ALL FOUR questions. All questions carry equal marks and the distribution of the marks for each question is given.

3. Please write all your answer in the Answer Booklet provided.

INSTRUCTIONS

There are FOUR questions in this section. Candidates MUST answer ALL questions.

Question1 (25 Marks)

a) Briefly explain the difference between beta as a measure of risk and variance as a measure of risk.

(5 marks)

b) Alisya plans to invest RM4,500 in the stock of Topaz and RM3,000 in the stock of Emerald. The possible returns for Topaz and Emerald are as follows:

State of Economy	Probability of State Economy	Returns if State Occurs	
		Topaz	Emerald
Boom	10%	12%	4%
Normal	65%	9%	6%
Recession	25%	2%	9%

i) Calculate the expected return for the investment portfolio?

(12 marks)

ii) Calculate the variance and standard deviation for the investment portfolio

(8 marks)

Question 2 (25 Marks)

a) Romee Nugget Enterprise is unlevered and is valued at RM640,000. Romee is currently deciding whether including debt in its capital structure would increase its value. The current cost of equity is 12%. Under consideration is issuing RM300,000 in new debt with an 8% interest rate. Romee would repurchase RM300,000 of stock with the proceeds of the debt issue. There are currently 32,000 shares outstanding and effective marginal tax bracket is zero. Calculate the new weighted average cost of capital (WACC).

(7 marks)

Continued...

b) Suppose a factor model is appropriate to describe the returns of a stock. The current expected return of the stock is 11%. Information about those factors is presented in the following table:

Factor	β	Expected value	Actual Value
Growth in GNP	1.8	2.1%	2.8%
Interest Rates	-1.2	3.5%	4%

i. What is the systematic risk of the stock return?

(6 marks)

ii. The firm announced that its market share had unexpected increased from 20 percent to 27 percent. Investors know from past experience that the stock return will increase by 0.40 percent for every 1 percent increase in its market share. What is the unsystematic risk of the stock?

(6 marks)

iii. What is the total return on this stock?

(6 marks)

Question 3 (25 Marks)

a) The Winter Wear Company has expected earnings before interest and taxes of RM2,100, an unlevered cost of capital of 14% and a tax rate of 34%. The company also has RM2,800 of debt that carries a 7% coupon. The debt is selling at par value. Calculate the value of this firm?

(8 marks)

b) A firm has a market value equal to its book value. Currently, the firm has excess cash of RM1,000 and other assets of RM6,000. Equity is worth RM18,000. The firm has 700 shares of stock outstanding and net income of RM1,200. What will the new earnings per share be if the firm uses its excess cash to complete a stock repurchase?

(9 marks)

c) What is the pecking order theory and what are the implications that arise from this theory?

(8 marks)

Continued...

Question 4 (25 Marks)

a) The inventory turnover for the Bharat Company was 8 times and its days sales in receivables was 55. What is the operating cycle for Bharat given a 365-day year?

(5 marks)

b) Your bank offers you a RM40,000 line of credit with an interest rate of 2.35% per quarter. The loan agreement also requires that 5% of the unused portion of the credit line be deposited in a non-interest bearing account as a compensating balance. Your short-term investments are paying 1.75% per quarter. What is your effective annual interest rate if you borrow the whole RM40,000 for the entire year? Assume that both the funds you borrow and the funds you invest use compound interest.

(4 marks)

c) Ramly is trying to decide whether to lease or buy some new equipment. The equipment costs RM62,000, has a 3-year life, and will be worthless after the 3 years. The pre-tax cost of borrowed funds is 5 percent and the tax rate is 40 percent. The equipment can be leased for RM22,500 a year.

i. Calculate the net advantage to leasing. **(13 marks)**

ii. Should Ramly lease or buy? **(3 marks)**

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